

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

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### **The Single Business Tax – Looking Back 30 Years** **By Jay Wortley, Senior Economist**

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In fiscal year (FY) 1975-76, Michigan began collecting a brand new tax called the single business tax (SBT). During its first year, it generated \$355.0 million. Today, some 30 years later, the tax is generating over \$1.9 billion. The single business tax was a unique tax when it was first enacted, and it definitely remains a one-of-a-kind tax. Over the years, many deductions, credits, and exemptions have been eliminated, replaced, or added to the SBT, and the tax rate has been cut almost 20.0%. The impact of all of these changes definitely has taken a toll on the SBT, by distorting and moving the tax away from the value-added concept and by making it very complicated. Complaints against the SBT have grown steadily. In fact, the tax has been characterized as a “jobs killer” and the tax businesses love to hate. Under current law, the SBT is scheduled to be repealed effective January 1, 2010. In addition, an effort is currently under way to accelerate the elimination of this tax. While FY 2005-06 marks the 30<sup>th</sup> year of SBT collections, it is not clear whether to throw this business tax a birthday party or a retirement party.

This article looks back 30 years ago and describes the situation and circumstances that led Michigan to adopt the SBT in the first place. It is interesting to note that some of the issues that led to the enactment of the SBT are the same issues that seem to be working against it today.

#### **Michigan and Value-Added Taxes**

The single business tax is a tax on the value a business adds to its product or service. A typical business purchases inputs to make its product or provide its service. The difference between the cost of these inputs and the amount that the business receives from selling the product or service is the amount of value the business has added to the product or service and this is essentially the base of a value-added tax.

The single business tax was not Michigan's first value-added tax. From 1953 to 1967, Michigan had a business activities tax (BAT) which was a form of a value-added tax. This tax was repealed in 1967 when Michigan adopted a personal income tax. Apparently, in order to get enough votes to pass the personal income tax, some legislators insisted that a similar tax be placed on business. As a result, a corporate income tax also was adopted in 1967. The corporate income tax was in place until 1975, when the SBT was enacted.

#### **Taxes the Single Business Tax Replaced**

When the SBT was adopted it replaced several taxes, not just the corporate income tax. In fact, the revenue from the corporate income tax accounted for less than half of the revenue the SBT replaced. In addition to the corporate income tax, the SBT replaced six other State taxes and a local tax. The name “single” business tax comes from the fact that this new tax was replacing various other taxes. Of these eight taxes that were repealed, the most significant ones in terms of the amount of revenue generated were the State corporate income and franchise taxes, and the local property tax on inventories. All eight repealed



taxes are listed in the following table along with their revenue yields for FY 1970-71 to FY 1973-74.

**Table 1**

<b>Michigan Taxes Replaced by the Single Business Tax (Millions of Dollars)</b>				
<b>Tax</b>	<b>FY 1970-71</b>	<b>FY 1971-72</b>	<b>FY 1972-73</b>	<b>FY 1973-74</b>
	<b>Total Revenue</b>			
Corporate Income Tax	\$152.6	\$269.2	\$368.0	\$295.1
Corporate Franchise Fee	132.9	140.2	153.4	157.7
Inventory Property Tax	223.3	231.2	238.9	253.0
Financial Institutions Tax	12.2	14.0	13.4	17.1
Intangibles Tax (business portion)	27.3	26.8	30.2	28.8
Income Tax on Unincorporated Business	2.0	3.3	3.6	4.0
Saving and Loan Privilege Tax	0.3	0.4	0.5	0.6
Insurance Privilege Tax	1.0	1.1	0.9	1.2
<b>Total Revenue</b>	<b>\$551.6</b>	<b>\$686.2</b>	<b>\$808.9</b>	<b>\$757.5</b>

**Source:** Senate Fiscal Agency; State of Michigan Financial Report, various years; "The Michigan Single Business Tax", Advisory Commission on Intergovernmental Relations.

### **Circumstances under which the SBT Was Adopted**

Moving back to a value-added tax and repealing eight existing taxes represented a major restructuring of Michigan's business taxes. When the plan was first proposed by Governor Milliken, it was not very popular. It was finally adopted, however, due largely to a combination of three factors: 1) The corporate income tax had some shortcomings that were hurting the State budget and the business climate, 2) Michigan's business taxes were being blamed, at least in part by some and in large part by others, for the poor business climate and economic performance, and 3) State government was facing a very large budget deficit.

Corporate Income Tax. In the 1960s and 1970s, Michigan's economy was even more dominated by the durable goods manufacturing sector than it is today. The volatile nature of the durable manufacturing sector caused large fluctuations in industries' financial success or lack thereof. As a result, this created significant swings in the level of corporate income tax receipts. For example, in FY 1970-71, corporate income tax receipts totaled \$153.0 million and then in FY 1971-72 they jumped \$116.0 million or 76.4% to \$269.0 million. At today's price level, that would be equivalent to an increase of \$540.0 million. These large swings in the corporate income tax helped create budget problems. Unexpected revenue growth one year led to increased spending only to be followed the next year by unexpected revenue shortfalls that required spending cuts and/or tax increases. In addition, businesses in the durable manufacturing sector were more than eager to eliminate the corporate income tax.

Michigan's Poor Economic and Business Climate. Michigan's unemployment rate averaged about 7.0% from 1970 to 1974 and then shot up to 12.5% in 1975. As a result, Michigan's unemployment rate averaged 7.8% from 1970 to 1975, which was 32.0% above the U.S.



average. This volatile nature of Michigan's economy helped contribute to the image that Michigan was not a good place to do business. In addition, the combination of Michigan's corporate income tax, franchise tax, and property tax on business inventories also was claimed to be a factor hurting Michigan's business climate. Proponents of the SBT argued that the SBT, through its capital acquisition deduction, would greatly reduce the tax burden on capital, compared with the corporate income tax, and would therefore promote capital investment and business expansion, and help create new jobs.

Looming Budget Deficit. The State faced a large budget deficit in FY 1975-76 of about \$180.0 million (equivalent to about \$840.0 million in today's dollars). Due to the timing of payments under the SBT, which is largely paid on a quarterly basis, and the corporate franchise tax, which was paid on an annual basis, switching to the SBT generated a cash flow gain of about \$180.0 million in FY 1975-76 and thus eliminated the need to make significant spending cuts.

### **Summary**

Thirty years ago many people viewed Michigan's business taxes as an impediment to the growth of some of the State's key sectors and believed that a change was needed to help revitalize the economy. The sweeping changes that transpired were not easy to make and probably would not have been made if the overall plan had not also solved the existing budget crises. Eliminating the SBT and finding a suitable replacement that will help revitalize the Michigan economy and not simply revisit prior problems also will be a very difficult task.